Computing a Retired-Worker Benefit

This section provides instructions and a worksheet for computing a retired-worker benefit. The worksheet can be used for persons born in 1924 through 1937—that is, those who attained age 62 in 1999 or earlier and were under age 75 at the end of 1999. The worksheet assumes that the worker had no prior period of entitlement to disability benefits and also did not work after becoming entitled to retired-worker benefits.

The worksheet describes the various steps used in computing a benefit. The steps are based on the following Social Security program goals.

To provide a benefit based on lifetime earnings. Benefits are related to earnings over a period of time that the worker could be expected to have worked in covered employment—from age 22 through age 61. The years of earnings considered are termed computation years. The worker's five lowest earnings years, including years of no earnings at all) are not considered in the computation. They are termed the drop out years.

To index lifetime earnings. Earnings used in the computation are not the actual covered earnings, but an amount for each year which reflects earnings increases in average wage levels after the year the earnings were paid. This procedure is termed wage indexing. Currently, earnings are generally indexed to wage levels in the year the worker turns age 60. For example, for a person attaining age 62 in 1999, actual earnings in 1984 of $20,000 are indexed to $33,995.51, based on 1997 wage levels. Earnings after age 60 are included at their actual (nominal) value.

To replace a portion of the indexed earnings. Indexed earnings are averaged over the number of computation years to calculate the Average Indexed Monthly Earnings (AIME). A benefit formula is applied to the AIME to produce the Primary Insurance Amount (PIA), the amount payable to a worker who retires at age 65. The benefit formula is weighted to provide a higher replacement of earnings for lower wage workers. The formula for persons age 62 in 1999 is 90 percent of the first $505 of AIME; plus 32 percent of the next $2,538; plus 15 percent of the AIME over $3,043.

To permit early retirement. Persons can retire as early as age 62, but the monthly benefit is reduced by 5/9 of 1 percent for each month of entitlement before age 65. The maximum reduction is 20 percent if he or she is entitled to benefits for all 36 months between 62 and 65.

To provide for price indexing after age 62. Benefits are adjusted annually in December to reflect increases in the Consumer Price Index (CPI-W). The 1998 benefit increase was 1.3 percent. These cost-of-living adjustments are applied to the benefit for each year after the person attained age 62—even if the person was not actually receiving benefits.

To give credit for earnings after age 61. Earnings after age 61 (which are not indexed) can be substituted for earnings in earlier years if they result in a higher benefit. In addition, persons who have benefits offset between age 65 and 69 due to the earnings test provision, may receive increased benefits as a result of the Delayed Retirement Credit (DRC) provision for each month for which a benefit was not received. The monthly benefit is increased by a specified percentage for each month a benefit was offset. For persons attaining age 62 in 1999, the percentage is 13/24 of 1 percent, resulting in an increase of 6 1/2 percent for each year for which benefits were not received.

Clarifying the Worksheet Procedure

Step 1 - Determining the Number of Computation Years

For persons who attain age 62 prior to 1991, the number of years used in the benefit computation equals the number of years after 1950 up to the year of attainment of age 62, minus 5 years. For workers who attain age 62 in 1991 or later, the number of computation years is 35.

Step 2 - Wage Indexing of Earnings

The following description and examples are provided for persons who wish to compute the index factors and indexed earnings. The indexing year is the second year prior to attainment of age 62. However, beneficiaries born on January 1 are deemed to have attained age 62 in the prior year, and consequently, the applicable indexing year, factors, and bend points are those for that year.

The average wage for the indexing year is divided by the average wage in each prior year to obtain the factor for each prior year. For example, a person attains age 62 in 1999. The indexing year is 1997. The average annual wage for 1997 was $27,426.00 The average annual wage for 1975 was $8,630.92. The amount, $27,426.00 divided by $8,630.92, yields a factor of 3.1776450.

The worker's actual earnings covered under Social Security in that year, up to the maximum earnings creditable, are multiplied by the indexing factor to obtain the indexed earnings. For example, actual covered earnings of $10,000 in 1975, multiplied by 3.1776450, result in indexed earnings of $31,776.45; actual earnings of $14,100 (the maximum creditable) result in indexed earnings of $44,804.79.

Step 3 - Computing the Average Indexed Monthly Earnings (AIME)

After the earnings in each year have been indexed, they are used in computing Average Indexed Monthly Earnings. The years of highest indexed earnings corresponding to the number of computation years are selected and totaled. This total is then divided by the number of months in the computation years. The result, rounded to the nearest lower dollar, is Average Indexed Monthly Earnings.

For example, for a person attaining age 62 in 1999, the highest 35 years of indexed earnings are used. If the sum of these earnings equals $400,000, the AIME is $952 ($400,000 divided by 420 = $952.38, rounded to $952).

Step 4 - Computing the Primary Insurance Amount (PIA)

The PIA, the amount from which all Social Security benefits payable on a worker's earnings record are based, is computed by applying a formula to the AIME. The formula consists of brackets in which 3 percentages are applied to amounts of AIME. The dollar amounts defining the brackets are called bend points, and the bend points are different for each calendar year of attainment of age 62. The PIA is rounded to the nearest lower ten cents.

For retired workers who attained age 62 in 1999, the bend points are $505 and $3,043. Thus the formula is 90 percent of the first $505 of AIME; plus 32 percent of next $2,538 of AIME; plus 15 percent of AIME above $3,043. The following are examples of PIA computations for such workers with different AIME amounts.

Example 1 - AIME of $300
PIA is $270
Based on: 90 percent of $300

Example 2 - AIME of $952
PIA is $597.54 rounded to $597.50
Based on: 90 percent of $505 ($454.50); plus 32 percent of $447 ($143.04)

Example 3 - AIME of $3,300
PIA is $1,305.21 rounded to $1,305.20
Based on: 90 percent of $505 ($454.50); plus 32 percent of $2,538 ($812.16); plus 15 percent of $257 ($38.55)

The above calculations are applicable to workers who attain age 62 in 1999. For workers who attained age 62 in prior years, the bend points will be different and the PIA must be increased to reflect cost-of-living adjustments between the year of attainment of age 62 and the year 1999. Worksheet 2 shows cost-of-living increase factors for 1979 through 1999. After the PIA is calculated for the year of attainment of age 62, cost-of-living increases are applied for each year through 1998. The result is the current 1999 PIA.

For example, a worker who attained age 62 in 1996 would receive cost-of-living adjustments for the years 1996–98. The adjustments are cumulative, with each step rounded to the next lower dime. If the age 62 PIA was $500, the cost-of-living adjustments would be:

1996: $500 multiplied by 1.029 = $514.50
1997: $514.50 multiplied by 1.021 = $525.30
1998: $525.30 multiplied by 1.013 = $532.10

$532.10 would be the PIA effective December 1998.

Step 5 - Computation of the Monthly Benefit

The full PIA is payable to a worker who retires at age 65. Workers can retire as early as age 62, but the monthly benefit is reduced by 5/9 of 1 percent, or 1/180, for each month of entitlement before age 65 (with a maximum reduction of 20 percent).

The final monthly payment is rounded to the nearest lower dollar. For example, the monthly benefit would be $433 for a worker with a PIA of $500 who retired at age 63. The PIA would be reduced by 13.33 percent (5/9 of 1 percent (0.0055555) multiplied by 24 months). The resulting reduction, $66.67, is subtracted from $500 to obtain $433.33, which is rounded to $433.